No. 3101.

United States
Circuit Court of Appeals,

FOR THE NINTH CIRCUIT.

Harris and Stevens Corporation, a Corporation, and C. C. Harris,

Appellants,

vs.

Tarr & McComb, Incorporated, a Corporation,

Appellee.

BRIEF OF APPELLEE.

CHARLES C. MONTGOMERY,
Attorney for Defendant and Appellee.

LYNN HELM,
Of Counsel.

Parker & Stone Co., Law Printers, 238 New High St., Los Angeles, Cal.

No. 3101.

United States

Circuit Court of Appeals,

FOR THE NINTH CIRCUIT.

Harris and Stevens Corporation, a Corporation, and C. C. Harris,

Appellants,

vs.

Tarr & McComb, Incorporated, a Corporation,

Appellee.

BRIEF OF APPELLEE.

STATEMENT.

May It Please Your Honors:

This is an appeal by plaintiffs from a decree sustaining defendant's motion to dismiss their complaint.

The motion was sustained generally.

No leave to amend was requested.

Defendant's main contention is:

"3. That there is insufficiency of fact to constitute a valid cause of action in equity against defendant." [Tr. p. 60.]

Appellants state the nature of the relief to which they claim they are entitled on page 9 of their brief thus:

"In the case at bar, the only relief sought is that the possession of the leased property be delivered by appellee to Harris and Stevens Corporation, one of the appellants herein, and an accounting be had."

As to whether there exists a right to an accounting that seems to depend under appellants' argument on the right to regain possession of the premises in dispute.

But, even if the right to an accounting exists by reason of some alleged default of defendant, nevertheless under the agreement under which appellants claim the default arose, appellants have expressly conferred on their trustee appointed by that agreement all right to call for such accounting and have limited the power of the trustee as follows:

"and that upon any default of said second party (Tarr & McComb, Incorporated) therein said Citizens National Bank (the trustee) on behalf of said first parties (appellants herein) and of said third parties (the creditors who are not joined herein) shall have and take such recourse against said second party for such default as might otherwise be had and taken by said first parties if this agreement were made and entered into between said first parties and said second party

only, provided always that in having and taking such recourse said bank shall act upon the direction of a majority amount of said creditors of said first parties * * *" [Tr. pp. 50, 51.]

The circumstances under which appellee obtained possession of the property are as follows:

Harris and Stevens Corporation, one of the appellants (plaintiffs below) was the owner of certain oil leases under which it had possession of the properties. [Tr. pp. 5, 6, 17, 24.]

While operating the properties Harris and Stevens Corporation made a contract with Tarr & McComb, Incorporated, appellee herein (defendant below), for the sale to the latter company of the entire output of oil from the properties. [Tr. pp. 6, 7, 33.]

Later, while operating under these leases and its said contract with Tarr & McComb, Incorporated, Harris and Stevens Corporation made assignments of the said leases to Tarr & McComb, Incorporated, for the purpose expressed as follows:

"This assignment is for the purpose of securing said Tarr & McComb, Incorporated, for all moneys now due from said Harris and Stevens Corporation to Tarr & McComb, Incorporated, or that may be hereafter advanced by said Tarr & McComb, Incorporated, to said Harris and Stevens Corporation or on their behalf, and further to secure any obligations or indebtedness that may hereafter be incurred or accrue on account of said Harris and Stevens Corporation to Tarr & McComb, Incorporated." [Tr. p. 39, 2nd par., and p. 43, 2nd par.]

With regard to possession of the physical properties, each of said assignments provided that Harris and Stevens Corporation continue operations under the leases according to the terms and conditions thereof, and further as follows:

"* * * or upon default in any of its indebtedness or obligations now or hereafter accruing or incurred by or on behalf of said company to Tarr & McComb, Incorporated, will upon demand in writing surrender possession of the premises to Tarr & McComb, Incorporated * * *" [Tr. p. 40 and pp. 43, 44.]

A number of months later appellants had become so financially involved that it became necessary to make some settlement with their creditors. Accordingly a creditors' agreement was signed by all except three creditors with claims aggregating $3,000. [Tr. pp. 7, 11.]

The creditors' agreement, referred to in the complaint as "Exhibit F" [Tr. pp. 7, 46], recites that Tarr & McComb, Incorporated, are creditors of Harris and Stevens Corporation in an amount $..... [Tr. pp. 47, 54.]

The complaint alleges that appellants had become indebted for about $40,000. "That all of said indebtedness was then due and payable." [Tr. p. 7.]

It thus appears that the indebtedness to Tarr & McComb, Incorporated, was in default, and that it was entitled to a surrender of possession of the premises to it under its assignments of the leases.

Three creditors with $3,000 worth of claims were refusing to sign the creditors' agreement.

The complaint states these three creditors had

"refused to sign and become parties to said agreement of March 12, 1917, and said creditors so refusing to sign and become parties to said agreement as aforesaid threatened that they would commence suits and actions against your orators for the recovery of their several claims, and would cause writs of attachment to be issued and levied against the hereinabove described tracts of real property, and both thereof, and the interests of your orators and the defendant therein." [Tr. p. 11.]

Under these circumstances possession was surrendered to Tarr & McComb, under their assignments of leases.

The complaint further alleges that at the time of surrender of possession,

"* * * Harris and Stevens Corporation was not possessed of any other property, * * * [Tr. p. 13.]

As a condition and as a result of the change of possession, the three outstanding creditors signed up the creditors' agreement.

With Tarr & McComb, Incorporated, in possession of the properties, the creditors' agreement was finally signed up and put in operation.

Furthermore, as the complaint alleges:

"* * * defendant has from time to time rendered to the said The Citizens National Bank of Los Angeles statements showing receipts and expenditures from the operation of said properties and has paid to said The Citizens National Bank of Los Angeles, for the benefit of all the said creditors of your orators, certain sums

of money to be by said bank disbursed to said creditors in partial payment of their respective claims, and the said The Citizens National Bank of Los Angeles has paid said sums of money so received by it from defendant as aforesaid to said creditors, who have received and receipted for the same." [Tr. pp. 12, 13.]

The creditors' agreement provided for extensions of time for payment of creditors every six months if $6,000 has been paid each period, thus allowing several years to work out the agreement [Tr. pp. 51, 52], and pay the $40,000 due with interest. [Tr. p. 7.] This suit was filed July 16, 1917, before the expiration of the first six months' period.

The creditors presumably have only been paid a small portion of the amounts due them.

The arrangement under which the agreement was finally signed, put in operation and a dividend paid, should not be disturbed, at least not until the creditors are paid in full.

Summary.

The owners of certain oil leases contracted to sell the entire production to another party. To secure its obligations and indebtedness contracted to such party the owners of the leases assigned same as security but retained possession of the leased properties until default.

Being on the verge of bankruptcy and in default to the assignee of the leases and having made an unsuccessful attempt to get a creditors' agreement signed up, possession was surrendered under said assignment of the leases.

The assignee in possession who had signed the creditors' agreement continues with the arrangement and obtains the outstanding creditors on the creditors' agreement.

All the creditors being signed up, operations were commenced and a dividend paid.

There is no allegation in the complaint giving any reason for disturbing the existing arrangement. There is no allegation, nor any inference, in the complaint indicating any agreement on the part of Tarr & McComb, Incorporated, that after the three creditors had signed it would return possession of the premises to Harris and Stevens Corporation. There is no allegation in the complaint that the three creditors who had signed the creditors' agreement after Tarr & McComb, Incorporated, had come into possession would be willing that Harris and Stevens Corporation should resume possession. There is no allegation in the complaint of any kind that there was any agreement for return of possession to Harris and Stevens Corporation after its surrender thereof to Tarr & McComb, Incorporated, certainly not until all the creditors had been paid in full.

ARGUMENT.

I.

The Surrender of Possession Was a Consideration for Outstanding Creditors to Join in the Creditors' Agreement if After Change of Possession They Joined Willingly. If So, the Creditors Are Indispensable Parties Defendant in a Suit to Revest Possession and This Action Must Fail for Lack of the Necessary Diversity of Citizenship and Because No Cause of Action Stated.

When the possession in controversy was surrendered to defendant Tarr & McComb, Incorporated, three of appellants' creditors with claims aggregating three thousand dollars had refused to join in the creditors' agreement of March 12, 1917, and were threatening attachments.

After the change of possession, these creditors signed the creditors' agreement, operations were prosecuted thereunder and dividends paid.

These creditors joined either willingly or unwillingly on account of the change of possession.

If they joined willingly the consideration for their joining was because Tarr & McComb, Incorporated, had come into possession in place of the failing debtor.

Tarr & McComb, Incorporated, had the most to gain from the effective and expeditious operation of the properties until the creditors were paid in full. They were not only creditors, and, as such, entitled to receive a creditor's dividends from the operation of the prop-

erties, but were also entitled to a seller's commission of 22½ cents per barrel [Tr. p. 48], and also, after the creditors were paid, would obtain an extension of their contract for the entire production of the properties without litigation with the creditors. [Tr. p. 47.]

It might well be that the surrender by the failing debtor of the possession of these properties to a creditor vitally interested in making them productive would be a consideration for these three outstanding creditors to sign the creditors' agreement.

If these three creditors after the change of possession signed *willingly* the creditors' agreement which they had refused to sign before the change of possession, the only inference to be drawn is that the change of possession was the consideration for their signing.

If the change of possession was the consideration for the signatures of these three creditors to the creditors' agreement, then they or their trustee are indispensable parties defendant in this action to revest the possession in plaintiff, Harris and Stevens Corporation.

If that be the case, the first ground of defendant's motion to dismiss was properly sustained, to-wit: because certain indispensable parties defendant are of the same citizenship as the plaintiff and therefore no diversity of citizenship exists.

In the case of *South Penn Oil Co. v. Miller* (4th Circuit), 175 Fed. 729, 736, the court said:

> "We also think the record discloses the fact that parties absolutely essential to the proper disposition of the questions decided by the court below were not before it, and that consequently, even

> had the subject-matter of the controversy been properly within its jurisdiction, the court could not have effectively disposed of it. Neither the lessors of the complainants, nor of the defendant, were made parties to the suit, and yet the final decree disposed of the funds in which they were interested, and decided the title to the property which they claim to own in fee simple."

Moreover, if the transfer of possession was the consideration for the outstanding creditors joining, it would be inequitable to revest the possession without their consent.

Appellants say (their brief, pp. 5 and 21) that there was no consideration for the transfer. There was. The pre-existing indebtedness due Tarr & McComb, Incorporated, the joining in the creditors' agreement, the holding for the benefit of the creditors, any one was sufficient consideration for the surrender of possession.

II.

If the Change of Possession Coerced the Outstanding Creditors Into Signing That Which They Otherwise Would Not Have Signed. If It Hindered and Delayed Them in the Collection of Their Debts, It Was a Fraud Upon Them and Debtor May Not Recover Such Possession.

If the creditors outstanding at the time that Harris and Stevens Corporation surrendered possession to Tarr & McComb, Incorporated, thereupon joined in the creditors' agreement, but joined unwillingly, if

they were coerced into joining by the change of possession, then the transfer was fraudulent in law in that it hindered and delayed them by preventing their levying attachments on the only property plaintiffs had, but which it is alleged in the complaint is worth $50,000, amply sufficient to satisfy a $3,000 indebtedness.

In *Dent v. Ferguson,* 132 U. S. 50, 33 L. Ed. 245, 246, 247, the court said:

Page 245:

> "What were the circumstances under which this instrument was executed? A. M. Ferguson was then possessed of a large estate in Memphis, consisting of valuable city lots with improvements, all estimated by competent witnesses to be worth $100,000, more or less. At the time he was indebted to various persons in sums which, we believe, it is admitted amounted to as much as the value of his property. * * *"

Page 246:

> "* * * The instrument itself was executed under circumstances which would lead a court to presume fraud upon creditors. It was a conveyance by a person deeply indebted, in anticipation of decrees and judgments, which, added to the existing incumbrances, amounted to the value of his property. * * *"

Page 247:

> "* * * A court of equity will not intervene to give relief to either party from the consequences of such agreement. The maxim, *'in pari delicte potior est conditio defendentis'* must prevail. * * *"

In II *Warvelle on Vendors* (2nd ed.), p. 730, the learned author states:

> "The effect of a fraudulent deed is to bind not only the grantor, but his heirs, privies and assigns, all, in fact, who claim by, through or under him.
>
> "To the general statements above made, and which constitute the universally recognized rule of law upon this subject, the writer has been able to find but one dissenting decision. This decision, while not denying the existence or merit of the general rule as stated, yet holds that when a party who has transferred his property with intent to delay or defraud creditors abandons his fraudulent purpose, and apprising the other party thereof seeks to reinstate himself in the possession of his lands, in order that he may apply them to the claims of his creditors, he may do so; and that the other party, who has been a participant in the fraudulent transaction, cannot hold the property and thus prevent it from being devoted to its legitimate uses."

The case of Carll v. Emery, 148 Mass. 32, mentioned in the above quotation as contrary to the generally accepted doctrine, is the case occupying page 17 of appellant's brief. But even if it were good law it is not applicable to this case, where the assignee in possession is and has been devoting the proceeds derived therefrom to the payment of the creditors, all of whom have come in under the creditors' agreement.

Appellants suggest (p. 13 brief) that by reason of some duress of appellee they were compelled to surrender possession and hence are not in *pari delicto*. No duress is alleged in the complaint, nor can any be

inferred from any of the facts stated in the complaint. The only duress mentioned in the brief is of the three creditors who had refused to join in the agreement. Their actions or influence are not imputable to appellee.

We agree with appellants' statement (brief p. 19),

"If the act of surrender of possession of the property herein was fraudulent, it is now purged of fraud."

The transaction is now valid. It should stand and not be set aside.

20 Cyc. 416;
Bigelow on Fraudulent Conveyances, p. 482.

A dividend having been paid the creditors under the assignment, they, who are the only ones entitled to avoid the same, have ratified and confirmed it. The transaction is purged of fraud so as to allow it to stand, not so that the fraudulent grantor can obtain a reconveyance.

III.

The Change of Possession Inures to the Benefit of the Creditors and Is Not Contrary to Any Agreement or Provision Contained in the Creditors' Agreement, But Is Consistent Therewith.

Appellants state in their brief on page 20 that unless they secured relief in equity the very object sought to be accomplished by the creditors' agreement will be defeated; that the creditors who signed became parties to the creditors' agreement "upon a misrepresentation of fact, the representation in the creditors' agreement

being that the appellants should have possession of and operate the property." There is no representation in the creditors' agreement to this effect. Counsel cannot find anything which even hints at Harris and Stevens Corporation retaining possession of the property; in fact, the creditors' agreement provided that the assignments of the leases

"* * * shall be and remain in full force and effect, upon the express understanding between all parties hereto that said assignments shall inure to the benefit of all of said creditors."

The purpose of keeping the assignments in full force and effect was to protect the creditors, and contemplated that there might be a change of possession as provided in the assignments. It can make no difference in the case that the change in possession took place before any operations rather than after debtor might have continued to operate and failed.

Conclusion.

The motion to dismiss the complaint of the plaintiffs in the District Court was properly sustained because,—

1. The complaint disclosed the fact that the contract of March 12, 1917, between the Harris and Stevens Corporation, Tarr & McComb and the Citizens National Bank of Los Angeles, and certain creditors of Harris and Stevens Corporation was not executed by three of the creditors of the said corporation. The effect of the contract, therefore, was manifestly to hinder, delay and defraud certain creditors of Harris

and Stevens Corporation who did not sign that agreement.

In accordance with the case of *Dent v. Ferguson,* 132 U. S. 50, 62, it was an agreement to hinder, delay and defraud creditors, and certainly under those circumstances, the plaintiffs being *in pari delicto,* could not recover back the property which they had proposed by that agreement to assign and transfer to the defendants.

2. If, however, all the creditors of the plaintiffs finally signed this agreement and made it valid as between creditors and plaintiff, it is a fair inference from the allegations of the complaint that the creditors all came into the agreement because the property was to be transferred to a third person to be held in trust until the claims of the creditors of the plaintiffs were satisfied. If this condition prevailed, certainly the Citizens National Bank, which acted as trustee of the funds, and the creditors who came into this agreement, are necessary parties to the suit. They are not only necessary, but absolutely indispensable. To turn the property back to the plaintiffs upon the first payment of a dividend of the claims of the creditors, without the claims being paid in full, would be to take away from the creditors and their trustee a substantial right, and would itself be a fraud on them. It is conceded by the plaintiffs in their complaint that if these creditors were made parties to the complaint it would oust the court of jurisdiction. The inducement to their becoming parties to the complaint was that

the plaintiffs, not being able to manage their own property and pay their debts, should turn it over to some one else, in trust, until the debts were paid. An assignment for the benefit of creditors is not illegal at common law.

3. There is no agreement alleged that when any portion of the indebtedness is paid the property is to be turned back to the plaintiffs. There was no agreement made in reference to its being turned back at all. If in equity it should be held that the object of this agreement was to make provision for the payment of the debts of the plaintiff, and that when the debts were paid a court of equity would decree that the property should be turned back to the plaintiffs, anything less than the full payment of the indebtedness would not entitle the plaintiffs to recover the property. In the absence of any agreement that the property should be turned back to the plaintiffs prior to the payment of every dollar of their indebtedness, there is no equity in their favor and no right on their part to at the present time insist upon the property being turned back to them. Therein the complaint is absolutely without equity. Counsel for appellants cannot point out a single provision that is made in any of these contracts for the turning back of the property to the appellants, and equity will not decree that it be turned back until all the conditions of the agreement entered into by all of the creditors of said plaintiffs are accomplished. Until that agreement is accomplished the possession of the defendants gives it no advantage, unlawful or otherwise, over plaintiff or other creditors. Counsel

claim in their brief on behalf of appellants that after the other creditors shall have been paid in full, appellee will have an advantage in being still possessed of the property. The answer to this is, that time has not yet come.

It cannot be said there is no consideration for this agreement of March 12th, or the one entered into by all the creditors of appellants, for an assignment for the benefit of creditors is itself a sufficient consideration.

4. If it should be claimed that the defendants had been guilty of any breach of trust in this matter it will demonstrate the necessity of having the Citizens National Bank and all the creditors of said plaintiffs made parties to this proceeding. Beyond peradventure, in such a case, the creditors of the bankrupt and said bank are indispensable parties to the suit, and while parties which are merely necessary parties will not oust the court of jurisdiction, parties who are indispensable and there is no longer diverse citizenship will oust the court of all jurisdiction whatsoever.

For these reasons the District Court committed no error in sustaining the motion to dismiss plaintiffs' complaint. Certainly the bill of complaint is without equity.

Respectfully submitted,

CHARLES C. MONTGOMERY,
Attorney for Defendant and Appellee.

LYNN HELM,
Of Counsel.